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No. 06-334

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IN THE

Supreme Court of the United States

DONALD F. APPOLONI, SR.; RUSSELL C. BERGEMANN; CHARLES BRYCE ENGLE, as personal representative of the estate of Sandra Engle; PHYLLIS F. KLENDER; and ROGER J. PETRI,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITIONERS' REPLY BRIEF

SUZANNE K. CLARK
LEE & CLARK
24901 Northwestern Hwy.
Suite 113
Southfield, MI 48075
(248) 350-5900

JOHN M. WEST
(*Counsel of Record*)
LAURENCE GOLD
BREDHOFF & KAISER, P.L.L.C.
805 Fifteenth Street, N.W.
Suite 1000
Washington, DC 20005
(202) 842-2600

Counsel for Petitioners

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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ARGUMENT

1. In its Brief in Opposition, the Government agrees with petitioners on the following points:

- This case "raise[s] questions of substantial and recurring importance." Br. in Opp. at 15.
- The Sixth Circuit's resolution of these important questions is in "significant tension" with the Eighth Circuit's resolution of the same issues in *North Dakota State University v. United States*, 255 F.3d 599 (8th Cir. 2001). Br. in Opp. at 7.

- While there are some differences in the facts upon which this case and the *North Dakota* case were resolved, "the correct application of 26 U.S.C. § 3121(a) [does not] turn[] on those factual distinctions." Br. in Opp. at 12.

Simply stated, then, the Government acknowledges that there is a conflict in the Circuits on the tax question of substantial and recurring importance squarely presented by this petition. The Government nonetheless opposes granting the petition on the ground that to do so would be "premature." Br. in Opp. at 16. It offers two reasons why the Court should wait for another occasion to address the question presented here that has divided the lower courts and that continues to spawn litigation. The first is based on factual differences in how tenure is granted in the school and university settings, *id.* at 11-13, and the second relies on Revenue Ruling 2004-110, 2004-2 C.B. 960, in which the Internal Revenue Service ("IRS"), while this matter was pending on appeal, addressed the question presented by this and the *North Dakota* cases. Br. in Opp. at 13-15. Neither presents a reason for delaying resolution by this Court of the question raised by this petition.

a. The issue presented is whether payments made to the petitioner school teachers to induce them to surrender their statutory entitlement to continued employment constitute "wages," as that term is defined in 26 U.S.C. § 3121(a). Notwithstanding the Government's acknowledgment that it "does not believe that the correct application of 26 U.S.C. 3121(a) turns on [the] factual distinctions" between petitioners' tenure rights under the Michigan Teachers' Tenure Act and the contractual tenure rights enjoyed by the university professors in *North Dakota*, Br. in Opp. at 12, the Government relies on these factual differences to insist that "no square conflict . . . exists" between the Sixth and Eighth Circuits. *Id.* at 13.

According to the Government, the grant of tenure to Michigan school teachers is "automatic," *id.* at 12, while the grant of tenure for the *North Dakota* university professors was an act of employer judgment. That is a false distinction. Neither Michigan public school teachers nor North Dakota university professors are granted tenure "automatic[ally] after a specified period of service." *Id.* To be sure, the factors upon which the tenure determination is based are undoubtedly different in the two settings, and the percentage of candidates to whom tenure is granted is undoubtedly much higher for K-12 teachers than for university professors. Nonetheless, in one case as in the other, the award of tenure represents the employer's judgment that the teacher or professor merits a lifetime appointment. *See Amato v. Oxford Area Cmty. Sch. Dist. No. 7*, 266 N.W.2d 445, 446 (Mich. 1978) (only a teacher "who *satisfactorily* completes probation is entitled to tenure") (emphasis added). That a school district may not continue to employ a teacher beyond the four-year probationary period without tenure being granted, Mich. Comp. Laws § 38.82, hardly means that tenure is "automatic"—as any teacher who has been "nonrenewed" at the end of the probationary period can attest. *See, e.g., Kentwood Pub. Schs. v. Kent County Educ. Ass'n*, 520 N.W.2d 682 (Mich. Ct. App. 1994).

The essential point for purposes of the question presented here is the same in both cases. Like the university professors in *North Dakota* for whom the grant of tenure resulted in a new legal "relationship" with their employer—in which the "initial at-will relationship during the probationary period" gave way to the "subsequent tenured relationship," 255 F.3d at 606—the grant of tenure to Michigan teachers results, by operation of state law, in a new and qualitatively different legal relationship between the teacher and his or her employing school district. *Compare* Mich. Comp. Laws §§ 38.81-38.84 *with id.*, §§ 38.91-38.121. Central to that new "relationship"—for the Michigan teachers like the *North*

Dakota professors—is the legal right to lifetime employment (absent "just cause" for dismissal). *See id.*, § 38.101. That legally enforceable right to continued employment is what both these petitioners and the *North Dakota* university professors gave up in exchange for the buyout payments from their employers. In that regard there is no material difference in the tenure right surrendered by the university professors in *North Dakota* and the tenure right surrendered by the petitioner teachers in this case. That is why, as the Government properly recognizes, the question presented here does not turn on any factual distinction in how tenure is granted in the school and university settings.

b. The Government also argues that "it would be preferable for the Court to address [this] issue in a case in which no possible uncertainty exists as to the applicability of Revenue Ruling 2004-110." Br. in Opp. at 15. In fact, there is no such uncertainty in this case. Because some of the buyout payments at issue were not due to be made until after January 12, 2005,[1] Revenue Ruling 2004-110 clearly would have to be addressed in determining whether those payments were subject to FICA taxation—whether or not the facts and circumstances of petitioners' payments were deemed to be "substantially the same" as in the abrogated Revenue Ruling 58-301, 1958-1 C.B. 23. *See* Br. in Opp. at 14. Both parties in the court below agreed that Revenue Ruling 2004-110 purported to apply to some or all of the payments at issue, and accordingly the effect of that ruling was fully briefed by both parties in the Sixth Circuit. Even though that court—given its resolution of the case against petitioners on other

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[1] While petitioner Petri had received all of the payments that were due him prior to January 2005, the monthly payments to which petitioners Appoloni, Bergemann, Engle, and Klender were entitled under their buyout agreements were to continue until September 2006. *See Appoloni* 6th Cir. Appendix at 135-36; *Klender* 6th Cir. Appendix at 136.

grounds—did not find it necessary to address Revenue Ruling 2004-110, there is no question that it would be squarely before this Court, should review be granted.[2]

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[2] It is not necessary, for purposes of determining whether to grant review, to decide whether the Government is right in contending that IRS revenue rulings are entitled to deference under the standard of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *See* Br. in Opp. at 14-15 n.3. It bears noting, however, that while this Court has not decided the issue, *see United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001), those courts that have recently addressed the degree of deference to which IRS revenue rulings are entitled—both before and after this Court's decision in *United States v. Mead Corp.*, 533 U.S. 218 (2001)—have held that IRS revenue rulings are *not* entitled to *Chevron* deference, but only to the lesser degree of respect that is appropriate under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). That is because, as the Sixth Circuit has explained, "[w]hen promulgating revenue rulings, the IRS does not invoke its authority to make rules with the force of law." *Aeroquip-Vickers, Inc. v. Commissioner*, 347 F.3d 173, 181 (6th Cir. 2003) (citing Rev. Proc. 89-14, 1989-1 C.B. 814). *See also O'Shaughnessy v. Commissioner*, 332 F.3d 1125, 1129 (8th Cir. 2003); *Omohundro v. United States*, 300 F.3d 1065, 1067-68 (9th Cir. 2002); *Del Commercial Props., Inc. v. Commissioner*, 251 F.3d 210, 214 (D.C. Cir. 2001); *Dominion Res., Inc. v. United States*, 219 F.3d 359, 366 (4th Cir. 2000); *First Chicago NBD Corp. v. Commissioner*, 135 F.3d 457, 458-59 (7th Cir. 1998). Indeed, the Tax Court treats revenue rulings as "merely the contention of one of the parties to the litigation." *Estate of Smead v. Commissioner*, 78 T.C. 43, 47 n.5 (1982).

The Government's further assertion that Revenue Ruling 2004-110 is entitled to deference under *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945), as "the agency's considered interpretation of its own regulations and prior rulings," Br. in Opp. at 15 n.3, is even farther off the mark. In issuing Revenue Ruling 2004-110 the IRS did not "interpret" its prior ruling in Revenue Ruling 58-301—it *abrogated* that interpretation of nearly 50 years' standing based on the IRS' new-found view that the earlier ruling had "erred in [its] analysis by failing to apply the Code and regulations appropriately." 2004-2 C.B. at 961. Revenue Ruling 2004-110 most assuredly does *not* "simply reflect the agency's longstanding interpretation of its own regulations." *Cleveland Indians*, 532 U.S. at 220. And, in any event, Revenue Ruling 2004-110 is so clearly contrary to the language of the statute and this Court's cases, *see* Petition at 21 & n.8,

2. The Government's brief also makes evident that, on the merits, the Sixth Circuit's interpretation of § 3121(a) is indefensible.

The most striking aspect of the Government's defense of the Sixth Circuit's decision, Br. in Opp. at 8-10, is the total absence of any attempt to reconcile that interpretation with the statutory language of 26 U.S.C. § 3121(a) and (b). Indeed, after brief mention in the opening paragraph of the Statement, the statutory language disappears from view. Instead, in apparent recognition of the difficulty in bringing payments made in exchange for surrender of a legally enforceable right to continued future employment within the statutory definition of "employment" as "service . . . performed" for the employer, 26 U.S.C. § 3121(b), the Government argues that the payments in question were not made in exchange for the surrender of such a right, but rather that "[r]elinquishment of tenure rights was simply a necessary and incidental part of accepting the buyout." Br. in Opp. at 10 (quoting Pet. App. 14a).

That formulation simply begs the question of what, then, was being "bought out," if not the teachers' legal rights, under the Michigan Teachers' Tenure Act, to continued future employment. The Government has no answer to that question. The payments cannot, as we pointed out in the Petition, fairly be characterized as compensation for the 10 or 20 years (depending on the particular buyout plan) of service to the school district that was the prerequisite for participation in the plan, because the petitioners' similarly situated colleagues—with equal years of service—who declined to accept the buyouts did not receive any such payments. Clearly, therefore, the payments were made in exchange for something more—not just satisfaction of the plan's service

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that it should not be followed even if the *Chevron* or *Bowles* standard were applicable.

prerequisite, but agreement to give up the legally enforceable right to continued future employment. *See* Petition at 16.[3]

There may well be, as the Government suggests, line-drawing issues at the margins between payments made in exchange for the surrender of statutory or contractual rights to continued future employment and payments for the relinquishment of seniority rights—which the IRS has treated as "wages." *See* Rev. Rul. 75-44, 1975-1 C.B. 15.[4] While the necessity of considering whether, and if so how, to draw such lines may well be reason enough for the Court to grant plenary review in this case rather than summarily reversing the Sixth Circuit, it does not change the fact that the question actually presented on the facts of this case is straightforwardly and properly resolved against the Government's

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[3] The assertion of the Government and the Sixth Circuit that in this case "longevity . . . was the key factor for determining eligibility," Br. in Opp. at 10 (quoting Pet. App. 11a), is true only to the extent that what is meant is eligibility for participation in the buyout plan. It is incorrect, however, to say that longevity was the "key factor" that determined who received a payment—which is the point that is relevant to determining what the payment was made in exchange for. Nor does this point provide any basis for distinguishing this case from *North Dakota*. There, as here, eligibility to participate in the plan turned on longevity (measured, in the *North Dakota* case, by a "rule of 70," *see* 255 F.3d at 601), but in both cases payments were made to employees only based upon their agreement to surrender their legally enforceable rights to continued employment. In neither case were any payments made to employees who merely met the longevity requirement.

[4] The fundamental distinction is clear enough, however. Seniority rights, which by their nature are earned through longevity in employment and nothing more, typically entitle the employee to higher pay and to preferences in job assignments, scheduling, vacation time, protection against layoffs, and the like, vis-à-vis fellow employees. Waiving such seniority-related preferences—which give the employee certain job benefits *as long as his or her employment lasts*—cannot be equated with accepting the buyout of a legally enforceable right to continued future employment.

position on the basis of the statutory language and in full accord with this Court's existing precedent.

3. The sum of the matter is that the Government's plea for the Court to leave the law on the important tax question presented by the petition in its present state of disarray is unsound and unjustified. Both employers and employees need certainty and uniformity in the interpretation of the tax laws with respect to an issue that arises so commonly and that involves substantial amounts of money. The instant case presents an appropriate vehicle for resolution of the question whether incentive payments made in exchange for surrender of a legally enforceable right to continued employment constitute "wages" on which FICA taxes are due, and the Court should not leave employer and employee taxpayers in the present state of uncertainty while this issue continues to divide the lower courts.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

SUZANNE K. CLARK
LEE & CLARK
24901 Northwestern Hwy.
Suite 113
Southfield, MI 48075
(248) 350-5900

JOHN M. WEST
(Counsel of Record)
LAURENCE GOLD
BREDHOFF & KAISER, P.L.L.C.
805 Fifteenth Street, N.W.
Suite 1000
Washington, DC 20005
(202) 842-2600

Counsel for Petitioners

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